Management Discussion & Analysis Report

Statement of Business Objectives

National Finance Co. SAOG ('National Finance' or 'the Company') was established in November 1987 and has now completed 25 years of operations. The Company's main business objective is to be the preferred provider of financial products to its target customer base of individuals and Small and Medium Enterprises (SMEs) in Oman. National Finance currently conducts its business from its headquarters at Muscat and six branches at Salalah, Sur, Sohar, Nizwa, Barka and Ibri.

As a public joint stock company regulated by the Central Bank of Oman, the company's business operations are subject to compliance with the regulatory and statutory guidelines of the Central Bank of Oman, the Capital Market Authority, the Company's own manual of authority & procedures and the legal statutes of the Sultanate of Oman.

The following discussion and analysis, in the opinion of the management, is useful in understanding the Company's financial results and position. The discussion and analysis have been made keeping the going concern concept in mind and need to be read together with the financial statements and related notes forming part of the annual report.

Certain statements in these discussions are forward-looking statements, including those that discuss strategies, goals, outlook or other non-historical matters; or projected revenues, income, returns or other financial measures. These forward-looking statements speak only as of the date on which they are made. The forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. Interest rate changes, demand and supply in the products financed, changes in Government regulations, tax laws etc., may have an influence on the financial results of the Company

Economic Environment Overview

Four years after the eruption of the global financial crisis, the world economy is still struggling to recover. During the year just past, we have seen considerable turmoil in Europe and the prospect of renewed uncertainty in the United States. Competitive attempts to devalue currencies among the largest economies in the world increase the risk of high inflation and recurrence of systemic issues. Continued weakness in the developed economies poses significant risk to the global economy.

Balanced against this, the stabilization of the crude oil price at higher levels has given considerable flexibility to governments in the region to invest and the positive growth in the last financial year could be attributed to continued high oil revenues and government spending. We are seeing increased traction on project implementation, job creation and a pick up in consumption expenditure.

While the fundamentals of the Oman economy remain strong, the fund flows of the domestic financial system are dependent on the changes and developments in oil prices to a large extent. The continuing flow of investment in the oil and infrastructure sectors has resulted in improving business confidence in the SME business community. The financial system remains quite liquid and the launch of Islamic banks should result in the infusion of further liquidity into the local economy.

Business Structure

Your company is one of the premier diversified non-banking finance companies in Oman, engaged in providing vehicle finance and loans to SMEs. The company enjoys a robust sourcing, underwriting, collection and operational model commensurate with the size and risks of the underlying asset class. Your company's major strengths are its customer base, dealer relationships, strong business practices and experienced and committed work force. As one of the oldest players in the industry your Company has a mature understanding of the market and has developed systems and processes that are constantly updated to meet the market demands and to face the challenges posed by the changing business environment.

The key strategies to enhancing the profitability in our business depend on the Company’s ability:

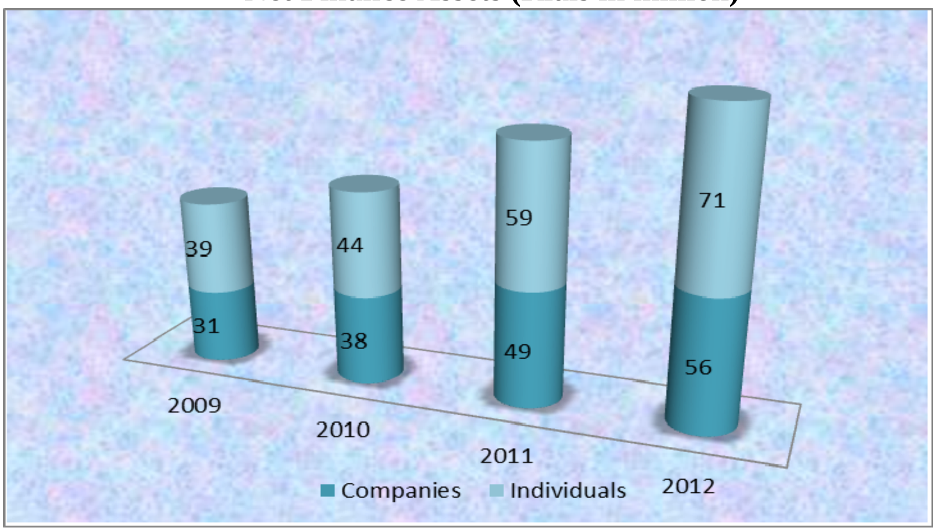
a) to lend money at spreads sufficient to maintain appropriate return for the risk undertaken
b) to maintain efficient operating platforms and infrastructure in order to run the business at competitive cost levels
c) to originate quality new business at optimal cost through multiple customer acquisition channels
d) to minimize the credit losses by proper evaluation of the credit worthiness of the customers, both during approval stage and post-disbursal collections
e) to maintain a strong capital base and to leverage the business at the optimal level

Performance Highlights

Vehicle & Equipment Finance

In vehicle finance, the company operates through established dealers as well as direct customer relationships while in the SME market the business is more focused on direct marketing. Our approach has been to restrict our target to lower risk customers.

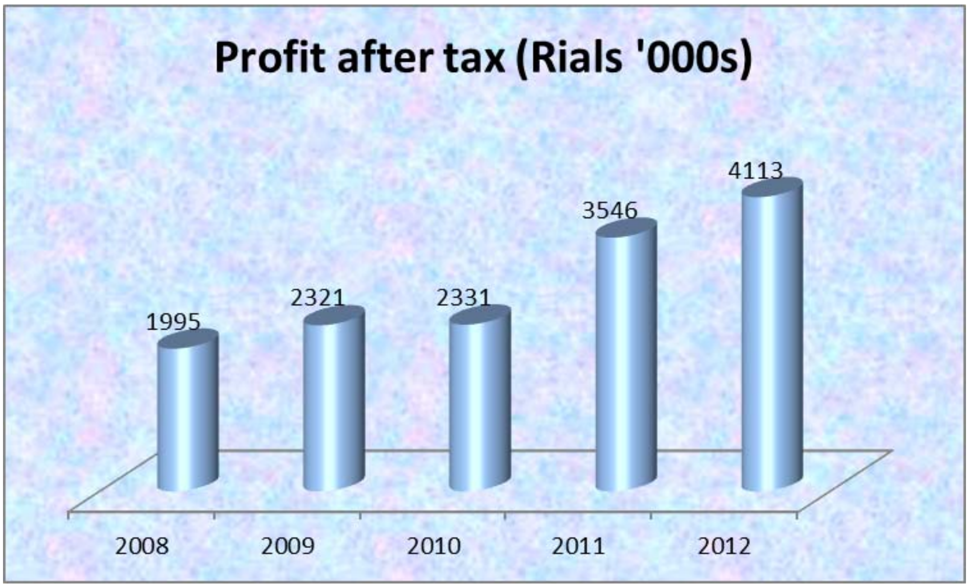
Net Finance Assets (Rials in million)

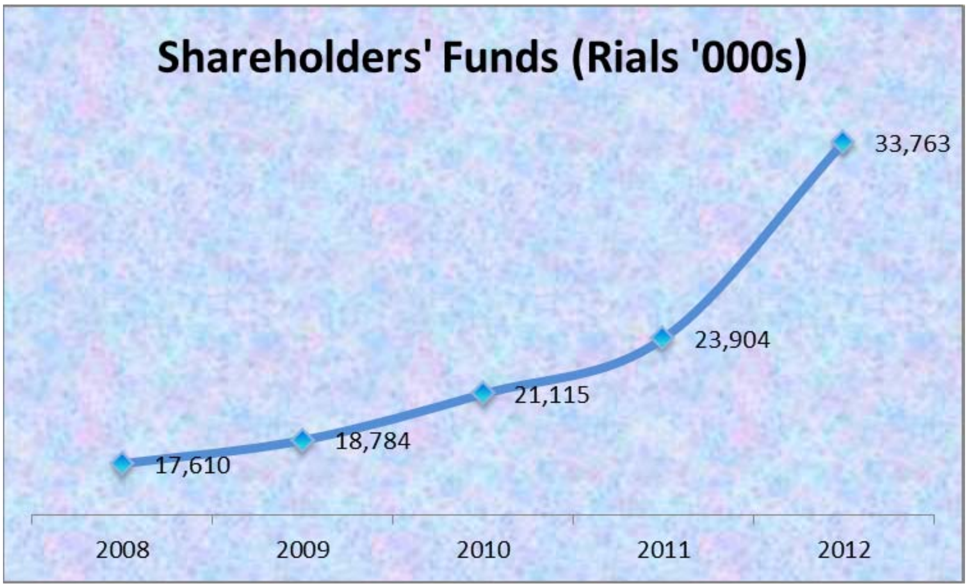


Operational Performance

Overall summary of performance for the year is as follows:

- Income from financing activities increased by 17.0%. Interest cost increased by 3.3% as a result of increase in borrowings. Consequently, net interest income increased by 17.4% to Rials 9.3 million (Rials 7.9 million FY-2011).
- General and administrative expenses increased by 6.6% to Rials 3.04 million (Rials 2.85 million).
- Profit after tax for the current year at Rials 4.11 million was up 16% from FY-2011 (Rials 3.55 million).





Funding Profile

During the year, we raised equity capital of Rials 7.5 million from our existing shareholders through a fully subscribed rights issue. Our equity capital has increased to Rials 25.06 million which means that we have already achieved the 2016 target regulatory capital of Rials 25 million. Our gearing is now at a level of 2.9 times as compared to our regulatory cap of 5 times. Our external funding comprises 2 main sources, bank borrowings and corporate deposits.

a) Bank Borrowings

Bank borrowings comprise our main source of funding. Since all our funding is from relationship banks with whom we have (and continue to cultivate) long term relationships, banks constitute a substantial source of stable funding for us. The company's total bank borrowings as at 31st December 2012 amounted to Rials 81.7 million as compared to Rials 68.5 million as at 31st December 2011.

b) Fixed Deposits

Fixed deposits are an alternate source of funding for FLCs. Fixed deposits carry the advantage of being fixed rate for the term; consequently, interest rate risk can be successfully mitigated to an extent. Our deposits tend to be from both stable relationship based depositors as well as more opportunistic one time depositors. As at 31 December 2012 the Company carried corporate fixed deposits totaling to Rials 12.3 million (Rials 13.3 million as of 31 December 2011).

Human Resources

National Finance firmly believes that its competitive edge is derived from its people. As a financial services company which takes pride in knowing and serving its customers better than most, people remain the Company's most valuable asset. The past success was built on the soundness of the Company's strategy which has been turned into action by the quality and determination of the employees. Going forward, the Company not only plans to maintain this key source of competitive advantage but also build on it through well-structured training initiatives.

With a rapidly changing business environment comes a need to constantly upgrade existing skill sets and to new challenges. During 2012, the focus of our Human Resources function has been on improving the skills of our employees by organizing various job based training programs. During the year the company conducted structured training programs in spoken English, risk assessment, leadership, motivation, customer service, anti-money laundering etc.

Preparing our Omani employees for the changing environment is a strategic imperative which is followed closely within the company. The Company is well equipped in terms of processes to continue to meet the upcoming requirements of growth. As of 31 December 2012, there were 139 employees of the Company of whom 112 employees were Omani nationals. The Omanisation ratio was at 80.6% which is higher than the statutory target of 80%.

Information Technology

The company considers Information Technology to be a key business enabler. During the year, the company successfully implemented the new IT software application. The new integrated software application will help the company to make faster and more effective utilization of its manpower resources. During the year the company conducted structured on the job training of the new IT application for all staff.

The company has a well developed and tested Disaster Recovery infrastructure which involves maintenance of operations in the event of loss of the main production system. The company has also put in place Business Continuity Plans as required by best practice for financial institutions.

Risks and Concerns

Managing risk is an inherent part of the Company's business. The Company's goal in risk management is to understand, measure and monitor the various risks that arise, and to evolve upto date policies and procedures to mitigate and manage these risks. The Company is primarily exposed to credit risk, interest rate risk, liquidity risk and operational risks.

The two key pillars of risk management for the company lie in:

- Adoption of standardized operating procedures;
- Review and audits to evaluate the extent of compliance as well as to spot any gaps.

Credit Risk

As the Company’s core business is lease financing, credit risk forms the major risk to which the company is exposed. Credit risk is the risk that a counterparty will cause financial loss for the company by failing to discharge an obligation. The management, therefore, carefully manages its exposures to credit risk. The company employs a range of policies and practices to manage, limit and control concentration of credit risk to individual counter parties, groups and industries.

The Company reviews and monitors credit exposures on an ongoing basis to identify early warning signals and take appropriate corrective action.

Operational Risk

Operational Risk is defined as the risk that the company will incur due to inadequate or failed internal processes, people or systems.

The management of operational risk is carried out through a comprehensive system of internal controls, documented delegation of authority, separation of duties between key functions and detailed standard operating procedures. The company has sought to minimize operational risk by centralizing complex and skilled processes and adopting best-in-class policies and processes in employee training, internal audit, fraud control, whistle blowing and information security.

Market Risk

Market risk is the risk of loss arising from changes in values of financial assets and liabilities and includes interest rate risk, foreign exchange risk and liquidity risk.

The Company engages in financial transactions in the normal course of business that exposes the Company to these market risks. The management conducts what it believes are appropriate management practices and maintains policies designed to effectively mitigate such risks. The objectives of the market risk management efforts are to preserve the economic and accounting returns of the assets by matching the re-pricing and maturity profiles of the assets with that of the liabilities.

Interest Rate Risk

Interest rate risk arises from the possibility of changes in interest rates and mismatches or gaps in the amounts of assets and liabilities that mature or re-price in a given period. Except for pricing the leases of varying maturity appropriately, the company does not actively hedge against interest rate risk.

Liquidity Risk

Liquidity risk is the risk that an enterprise will encounter in raising funds to meet its obligations at any given time.

The mitigation techniques deployed by the company is to spread the borrowing basket among different banks to reduce the concentration risk. It also monitors the structural liquidity mismatches between the assets and the liabilities on a projected cash flow basis and periodically reviews the open credit lines available with the banks. The liquidity risk is reviewed on a monthly basis by the ALCO.

Foreign Currency Risk

Foreign currency risk is the risk that arises from assets or liabilities denominated in a currency that is not the entity's functional currency. Foreign currency transactions of the company are restricted to US Dollar denominated borrowings. Since the Rial is pegged to the US Dollar, foreign exchange risk is considered low. In addition, the company has the option of entering into forward exchange contracts, where necessary, to hedge any significant risks arising from foreign currency transactions.

Internal Control Systems

The company has put in place extensive internal controls to mitigate risks. An established set of procedures provides clear delegation of authorities and standard operating procedures for all parts of the business. Clear segregation of duties exists between various functions. The in-house internal auditor evaluates the adequacy and effectiveness of controls and all audit findings are independently reported to the Audit & Risk Management Committee of the Board of Directors. The Audit & Risk Management Committee monitors the implementation of enterprise-wide risk management and control and the company's compliance with regulations. The company has a strong IT security system to ensure information security.

Future Outlook

The country's budget envisages substantial expansion in infrastructure investments and also calls for the creation of a large number of jobs in the public and private sectors. In addition, the eighth five year planned expenditure has been increased substantially. These developments are positive for our SME and retail businesses.

Balanced against these positive market developments is the substantially higher competition with the greater penetration of commercial banks and the launch of Islamic banks. Overall, we expect the outlook for the finance and leasing industry to remain challenging. While liquidity is expected to remain easy, we expect spread compression due to some increase in funding costs and increased competition for business.

Your Company will continue to strive hard to improve its service levels, the main differentiator in service oriented industries, and will continue in its pursuit to develop strategies for maintaining margins through efficient operations. This combined with improved asset quality and focus on maintaining good collections is expected to provide satisfactory returns to our shareholders.

Robert Pancras
Chief Executive Officer